

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01
INR-10 NSAE-00 ICA-20 TRSE-00 XMB-04 OPIC-06
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 L-03 H-02 PA-02 /110 W
-----093078 271357Z /42

R 271507Z JUL 78
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 5514
INFO AMEMBASSY BRUSSELS
AMEMBASSY LISBON
AMEMBASSY PARIS

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USOECD

USEEC

E.O. 11652: N/A
TAGS: EALR, ECON, EFIN, ETRD, PINT, SP
SUBJECT: PROMINENT ECONOMIST FUENTES QUINTANA REVIEWS
THE SPANISH ECONOMY

REF: MADRID A-102

1. SUMMARY. FORMER VICE PRESIDENT FOR ECONOMY FUENTES QUINTANA HAS WRITTEN RECENTLY THAT ALTHOUGH SPANISH ECONOMIC POLICY WAS SUCCESSFUL IN THE LAST TWELVE MONTHS, MUCH REMAINS TO BE DONE BEFORE THE ECONOMY IS STABILIZED. FUENTES CALLS FOR ACCEPTANCE BY "POLITICAL AND SOCIAL FORCES" OF AN ACCORD TO LIMIT WAGE HIKES. HE ALSO . RECOMMENDS CAUTIOUS MONETARY POLICY, AND VIGILANCE IN THE RELATED MATTER OF THE PUBLIC SECTOR FISCAL DEFICIT. POLICIES PROMOTING FREER TRADE ARE URGED. FUENTES ASKS FOR FURTHER STRUCTURAL REFORMS, ESPECIALLY OF THE
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FINANCIAL SYSTEM AND SOCIAL SECURITY. END SUMMARY.

2. AN OPINION WHICH COUNTS. PROFESSOR ENRIQUE FUENTES QUINTANA, FOR YEARS ONE OF SPAIN'S LEADING ECONOMISTS, BECAME VICE PRESIDENT OF ECONOMY IN JULY 1977. ON TAKING OFFICE HE INITIATED AN ECONOMIC STABILIZATIOO PROGRAM WHICH ALSO PROVIDED FOR EXTENSIV STRUCTURAL

REFORMS. WHEN HE RELINQUISHED THIS POST IN FEBRUARY HE LEFT HIS KEY POLICIES INTACT, AND EMBODIED IN THE MONCLOA ECONOMIC PACT. RECENTLY HH SUMMED UP FOR "ACTUALIDAD ECONOMICA" HOW THESE PROGRAMS HAVE FARED, AND ADDED HIS VIEWS ON POLICIES FOR THE FUTURE.

3. THE WAGE ISSUE. REAL WAGES INCREASED IN 1977 AND, AS A RESULT OF THE MONCLOA AACT, ARE INCREASING AT A FASTER RATE THIS YEAR. WAGES WOULD HAVE RISEN EVEN MORE RAPIDLY, FUENTES WRITES, IN THE ABSENCE OF A PACT BECAUSE EMPLOYERS HAD A DEMONSTRATED WILLINGNESS TO ACCEDE TO LABOR DEMANDS. SPAIN MUST HAVE A POLICY TO MODERATE WAGE GROWTH IN ORDER TO RETURN TO SUSTAINED INCREASES IN PRODUCTION AND EMPLOYMENT. ASSOCIATED LABOR COSTS - PRINCIPALLY PAYROLL CHARGES FOR THE SOCIAL SECURITY SYSTEM - MUST ALSO BE CONTAINED. IT IS CLEAR, ACCORDING TO FUENTES, THAT THE WORKING CLASS IN OTHER COUNTRIES . HAS NOT REALLY BENEFITED WHEN IT HAS CONCENTRATED ON GAINING HIGHER WAGES (PRESUMABLY REFERRING TO CONSEQUENT RISES IN INFLATION AND UNEMPLOYMENT). THE SPANISH WORKING CLASS HAS MORE TO GAIN FROM INCREASED PRODUCTION OF PUBLIC GOODS AND SERVICES, FINANCED BY A MORE EQUITABLE TAX SYSTEM. THIS WOULD YIELD AN IMPROVED QUALITY OF LIFE AND BETTER WORK ENVIRONMENTS.

4. THE MONEY SUPPLY. FUENTES CHARACTERIZED GOS MONETARY UNCLASSIFIED

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POLICY AS "PASSIVE" PRIOR TO HIS ASSUMING THE VICE PRESIDENCY. THE MONEY SUPPLY WAS BEING EXPANDED RAPIDLY AND THIS SERVED SEVERAL PURPOSES: IT AVOIDED ANY DIFFICULTIES IN PAYING FOR HIGHER COSTS (WHICH WERE PARTLY CAUSED BY THE MONETARY POLICY ITSELF); IT PROVIDED EASY CREDIT FOR BUSINESSMEN; IT COVERED UP FOR A RISING FISCAL DEFICIT; AND IT SERVED TO EVADE THE NEED FOR TAX REFORM.

5. STABILIZATION A SUCCESS, BUT ONLY PROVISIONALLY.. ACCORDING TO FUENTES, WHO MANAGED LAST FALL'S MONCLOA ECONOMIC NEGOTIATIONS, THE STABILIZATION TARGETS AGREED ON IN THE PACT WERE APPROPRIATE IN VIEW OF THE NEED TO CONCLUDE A SOCIAL PACT. A PACT WAS NECESSARY TO AVOID POLITICAL POLARIZATION AT A SENSITIVE PERIOD IN SPANISH - HISTORY. PACT TARGETS SUCH AS THOSE FOR MONEY GROWTH AND WAGE HIKES WERE AT LEVELS CONSISTENT WITH THE NEED FOR "GRADUALISM". THE RESULT HAS BEEN SUCCESS IN TERMS OF THE TARGETS SET, WITH MUCH REMAINING TO BE DONE BEFORE THE ECONOMY IS FULLY STABILIZED. IT IS STILL POSSIBLE, FUENTES POINTS OUT, TO LOSE WHAT GAINS HAVE BEEN MADE SINCE LAST JULY -- GAINS WHICH HAVE BEEN OBTAINED AT

THE COST OF SLOW ECONOMIC GROWTH AND RISING UNEMPLOYMENT.

6. STRUCTURAL REFORMS STILL NEEDED. FUENTES WRITES THAT THE GOVERNMENT IN SOME CASES HAS NOT COMPLIED WITH STRUCTURAL REFORM PROVISIONS IN THE MONCLOA PACT. FURTHER REFORM OF THE FINANCIAL SYSTEM IS A NECESSITY IF VIABLE DOMESTIC ALTERNATIVES TO FOREIGN BORROWING ARE TO BE CREATED. SPAIN NEEDS A SYSTEM OF MEDIUM AND LONG TERM FUND INTERMEDIATION, CREATION OF WHICH WILL MAKE MONETARY POLICY EASIER TO EXECUTE. THE PROMISED REFORM OF THE SOCIAL SECURITY SYSTEM IS ALSO OF MAJOR IMPORTANCE DUE

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SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 L-03 H-02 PA-02 /110 W
-----093225 271359Z /42

R 271507Z JUL 78
FM AMEMBASSY MADRID
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TO THE SYSTEM'S INEFFICIENCY AND TO THE GREAT IMPACT OF ITS DEFICITS ON FISCAL POLICY.

7. TRADE POLICY. FUENTES POINTS OUT THAT THE TRADITIONAL SPANISH DEVELOPMENT MODEL HAS BEEN BASED ON HIGH PROTECTIVE TRADE BARRIERS AND AN OVERVALUED CURRENCY. HE ARGUES THAT THE MARKET-ORIENTED DEVELOPMENT MODEL NOW BEING PURSUED REQUIRES A DIFFERENT TRADE STRATEGY. A REALISTIC EXCHANGE RATE IS NEEDED IN ORDER TO AVOID FAVORING IMPORTATION AND PENALIZING EXPORTATION. FUENTES URGES STRONGLY THAT SPANISH TARIFFS BE REDUCED. NATIONAL RESOURCES MUST BE INCREASINGLY DIRECTED TOWARDS EXPORTS, AND EXPORT TAX REBATES (DESGRAVACION FISCAL) MUST BE RATIONALIZED. ALL THIS, HE EMPHASIZES, WILL REQUIRE "POLITICAL BRAVERY" IN THE FACE OF SPECIAL INTEREST GROUPS.

8. HOW TO SUCCEED. FUENTES BELIEVES THAT AN ACCORD BY "SOCIAL AND POLITICAL FORCES" WILL BE NEEDED IN ORDER TO FOLLOW UP ON THE MONCLOA ECONOMIC PACT. THIS ACCORD WILL BE DIFFICULT TO ACHIEVE BECAUSE LABOR UNIONS WILL UNCLASSIFIED

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BE RELUCTANT TO EXCHANGE SALARY DEMANDS FOR PROMISES OF REFORMS. WHILE FUENTES DOES NOT PROVIDE ANY FURTHER. DETAIL ON WHAT SUCH AN ACCORD SHOULD CONTAIN, HE STATES THAT THE FUTURE OF THE SPANISH ECONOMY DEPENDS ON THREE MATTERS:

- 1) LABOR COSTS AND INCOMES POLICY;
- 2) REDIRECTION OF NATIONAL RESSURCES TOWARDS EXPORTS, AND ADOPTION OF APPROPRIATE TRADE POLICIES; AND
- 3) MONETARY POLICY, AND FACTORS SUCH AS THE FISCAL DEFICIT WHICH CONDITION THIS POLICY' TODMAN

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMISTS, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 27 jul 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 jan 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978MADRID08630
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780308-0329
Format: TEL
From: MADRID USOECD
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780714/aaaaalxk.tel
Line Count: 194
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: e837d76b-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: 78 MADRID A-102
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 29 mar 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 1869171
Secure: OPEN
Status: NATIVE
Subject: PROMINENT ECONOMIST FUENTES QUINTANA REVIEWS THE SPANISH ECONOMY
TAGS: EALR, ECON, EFIN, ETRD, PINT, SP
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/e837d76b-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014